

OPINIONS OF THE ATTORNEY GENERAL

VOLUME NO. 39

OPINION NO. 1

LANDS - State lands, leases, subleases, exercise of the preference right;
LEASES - State lands, subleases, exercise of the preference right;
STATE LANDS - Leases, subleases, exercise of the preference right;
MONTANA CODE ANNOTATED - Sections 77-6-205, 77-6-208, 77-6-211.

- HELD: 1. A lessee who subleases the entire tract for the entire lease period is not entitled to exercise the preference. Lessees who sublease only a portion of the tract for the entire term must be judged on a case-by-case basis to determine whether the goals of sustained yield are being met as required in Jerke.
2. Lessees who sublease all or part of the tract for only a part of the term will lose their preference right if, on a case-by-case basis, it is determined that the goals of sustained yield are not being met as required in Jerke.
3. The holdings in Skillman and Jerke must be applied to leases as they come up for renewal.
4. A lessee who violates his lease loses his right to renew or the preference right only if the Board determines that the violations are serious enough to warrant cancellation.
5. Lease reinstatement pursuant to section 77-6-211, MCA, restores the preference right to a lessee who has violated the terms of his lease.
6. An assignee of a lessee who has violated the terms of his lease enjoys all rights of a new lessee who has not violated the terms of his lease.

9 January 1981

Gareth C. Moon, Commissioner
Department of State Lands
1625 Eleventh Avenue
Helena, Montana 59601

OPINIONS OF THE ATTORNEY GENERAL

Dear Mr. Moon:

You have requested my opinion on the following questions:

1. Are lessees who have subleased all or part of state land for the entire lease term entitled to exercise the preference right?
2. Are lessees who subleased all or part of state land for only a portion of the lease term entitled to exercise the preference right? An associated question is whether those individuals who entered into sublease arrangements after the Jerke or Skillman decisions are entitled to exercise the preference right.
3. During the past ten years which is the term for most state leases, many competitive bids were submitted on tracts that were subleased. These lessees were allowed to exercise the preference right since it was assumed valid at the time. Do those lessees have valid leases at this time?
4. If a lessee violates the terms of his lease, even inadvertently, has he lost the right to renew the lease and the preference right?
5. Does lease reinstatement pursuant to section 77-6-211, MCA, restore the preference right to a lessee who has violated the terms of his lease?
6. If a lessee who has violated the terms of his lease loses the preference right, is a subsequent assignee of the lease entitled to exercise those rights?

These questions arise from the considerable difficulty of applying two recent decisions from the Montana Supreme Court. On March 2, 1979, the Court decided Jerke v. State Department of Lands, ___ Mont. ___, 597

OPINIONS OF THE ATTORNEY GENERAL

P.2d 49 (1979), involving state grazing land leased by a grazing district. The district allocated the land to one of its members but did not use the land itself. At the end of the district's lease a third party submitted a competitive bid on the tract, but the district exercised a preference right under section 77-6-205, MCA, to retain the lease. This, the Court held, was an unconstitutional application of the preference in that it set up the district, and not the state, as trustee of the land. Since the district itself did not actually use the land, the Court said the district's exercise of the preference right did not further the legislative policy of sustained yield. The Court did say the preference right furthered sustained yield in the case of a lessee who actually used the land since it furnished an incentive for the lessee to exercise good management and to make improvements. In Skillman v. Department of State Lands, ___ Mont. ___, ___ P.2d ___ (1980), the Court applied Jerke to preclude the exercise of the preference right by an individual lessee who has subleased the land.

The preference right provides that when competitive bids are received on a tract of state land at the end of a lease term, the prior lessee has the automatic right to renew by meeting the high bid. § 77-6-205, MCA. When a lessee exercises the preference right he may request a hearing if he can furnish reasons why the high bid is excessive or otherwise not in the state's best interest. After hearing, the Board of Land Commissioners may reduce the lease rate. (§ 77-6-205(2), MCA.) Subleasing of state lands has long been recognized by statute (§ 77-6-208, MCA), and it is the interplay of subleasing with the preference right that has led to the results in Jerke and Skillman.

Your questions will be discussed individually.

1. Are lessees who have subleased all or part of the state land for the entire lease term entitled to exercise the preference right?

It is assumed for the purposes of this question that the lessee has properly filed his sublease with the Department. It is clear from Jerke and Skillman that a state land lessee who leases the entire tract for the entire lease period is not entitled to exercise the preference right of section 77-6-205, MCA. That was the situation in both of those cases.

OPINIONS OF THE ATTORNEY GENERAL

The situation in which a lessee subleases only a portion of the tract is more difficult, and the Court has not addressed this specific question. Partial subleasing may occur for a number of reasons. Some portion of the land may be agricultural, while the lessee conducts only a grazing operation. In other cases a road, creek, or other natural barrier may make it impractical for the lessee to use part of the land for his operations, while at the same time a neighbor could use the lands to great advantage. Because circumstances vary greatly with the use of state land by lessees there may be numerous reasons which exist for legitimate subleases. The Court did not address mitigating factors such as these in either of the cases, at least in the situation of a total sublease. However, the Jerke rule may not be violated in situations in which a minor portion of the land is subleased for good reasons or where the lessee retains sufficient actual control to assure sustained yield of the land. For example, if a lessee of 160 acres of land subleases ten acres located across a river or a country road from his ranch it would appear to be unduly harsh to deny his preference right for that reason alone. This is especially true when the problem could be cured initially by splitting the isolated piece of the tract into another lease. The basic point of Jerke was to insure the furtherance of sustained yield by encouraging good management through insuring continuity in leasing. In our example, allowing the lessee the preference right would, under this logic, encourage him to use good management on the vast portion of the tract; it would encourage him to comply with his lease terms in order to retain the lease because he could offset a portion of his costs through subleasing; and it would put the ten acres to use while it might otherwise sit idle. Furthermore, the lessee could insert contractual provisions to require for example that the sublessee practice good management practices, that he obtain the lessee's permission to move stock on and off the land, or that he remove or rotate stock at the lessee's direction. The control that the lessee retains which would be sufficient to insure sustained yield will vary from case to case and in any event must be real and not illusory.

The practical problem with this approach is determining at what point the goals of Jerke are no longer being met. That is, if subleasing 10 acres of 160 for good

OPINIONS OF THE ATTORNEY GENERAL

8reason is acceptable, what about 20, or 40, or 60 or more? The factors to be considered are first, whether there is good reason for subleasing a portion of the tract and secondly whether the lessee retains sufficient immediate control over the tract to insure that sustained yield is being accomplished in a manner consistent with Jerke. Since there are no regulations to follow, this necessarily must be done on a case-by-case basis. If this question arises in any substantial number of instances, it will obviously be quite burdensome for the Department. The drafting of regulations in anticipation of this problem would be appropriate.

2. Are lessees who subleased all or part of the state land for only a portion of the lease term entitled to exercise the preference right?

This issue was not expressly addressed in either Jerke or Skillman. As was true in the first question, hardship situations can be imagined. For example, a lessee subleases the tract, or a portion of it, for one year of a ten-year lease and has a good-faith intent to use the land himself for the renewal period if allowed to exercise the preference right. It would not appear to violate the goals of Jerke to allow this lessee to exercise the preference right. On the other hand, a lessee who has subleased the land for eight years out of ten and who has not taken action to protect sustained yield would seem for all practical purposes to be in a situation like that condemned in Jerke and Skillman.

As suggested in the second part of the answer to the first question, the factors to be considered are first, whether there is good reason for having subleased, and second whether the lessee retained immediate control over the tract to insure that he can exercise good management to attain sustained yield in a manner consistent with Jerke. Once again since there are no regulations to follow this must be done on a case-by-case basis and may prove very burdensome to the Department. Again regulations should be considered in anticipation of this problem.

3. During the past ten years, which is the term for most state leases, many competitive bids were submitted on tracts subleased by the lessee. These

OPINIONS OF THE ATTORNEY GENERAL

lessees were allowed to exercise the preference right since it was assumed valid at the time. Do these lessees have valid leases at this time?

This question is addressed in part, and by implication, in Skillman. In that case the lease expired, the competitive bid was submitted, and the preference right was exercised all prior to the announcement of the decision in Jerke. Nonetheless, without any mention of retroactivity (see, e.g., State v. Campbell, ___ Mont. ___, 36 St. Rptr. 1264 (1979)), the Court applied Jerke and invalidated the exercise of the preference right. At the same time the Court expressly recognized that the lessee was under the impression that he had a valid preference right when he exercised it and that "he should not be penalized for that good faith belief." While the lessee was obviously penalized by having his preference right terminated, the Court did recognize his legitimate expectations and seemed to be saying that he should not be penalized any further. Jerke was clearly applied retroactively and that issue was briefed and argued to the Court.

However, based upon the Court's recognition of pre-Jerke expectations and practice, it is unlikely that they would require the immediate retroactive invalidation of all leases issued in this manner in the last ten years. On the other hand, it is equally clear, based upon what actually happened in Skillman, the Jerke holding must be applied to those leases as they come up for renewal.

4. If a lessee violates the terms of his lease, even inadvertently, has he lost the right to renew the lease and the preference right?

It is assumed that this question is asked in the context of a lessee who has not subleased. Even so, there are two distinct situations which seem to be involved. First, section 77-6-205, MCA, provides that a lessee who has paid his rent and "has not violated the terms of his lease" is entitled to renew his lease for a comparable term. Second, section 77-6-205, MCA, then provides that if a competitive bid is received, the lessee has a preference right to renew by meeting that bid.

The language concerning violation of the lease must be construed to apply to both a simple renewal and to a renewal by preference right. Otherwise a lessee who had

OPINIONS OF THE ATTORNEY GENERAL

violated his lease would be penalized when no one else wanted the land, but not if competitive bids were received. That result would make no sense at all.

In Skillman the Court raised the "serious question" of whether a lessee who violates his lease has either a right to renew or a preference right. (The lessee there had subleased without approval.) The Court did not decide the issue, however, assuming arguendo that the violation was not serious enough to deprive the preference right.

If section 77-6-205, MCA, were the only statute on the subject it could easily be construed to require loss of both the right to renew and the preference right upon violation of lease terms. However, section 77-6-211, MCA, allows the Board to examine lease violations to determine whether they are "serious enough to warrant cancellation." If violations are not serious, the lessee's "rights and privileges" under the lease "shall be preserved." These rights and privileges clearly include both the right to renew and the preference right.

The clear impact of these statutes on the present question is that a lessee who violates his lease loses his right to renew or preference right only if the Board determines that the violations are sufficiently serious to warrant cancellation.

5. Does lease reinstatement pursuant to section 77-6-211, MCA, restore the preference right to a lessee who has violated the terms of his lease?

As indicated above in response to the last question, the answer is "yes."

6. If a lessee who has violated the terms of his lease loses the preference right, is a subsequent assignee of the lease entitled to exercise those rights?

An assignee of all the lessee's rights to the lease (assuming the lease was properly assigned under section 77-6-208, MCA) is entitled to enjoy the preference right. In effect he becomes a new lessee and, as long as he has not violated the lease or the law, retains all

OPINIONS OF THE ATTORNEY GENERAL

lessee rights. This includes the renewal and preference rights of section 77-6-205, MCA. This conclusion furthers wise management of the land by giving an incentive to a lessee who will actually use the land to take over the lease from one who will not.

THEREFORE, IT IS MY OPINION:

1. A lessee who subleases the entire tract for the entire lease period is not entitled to exercise the preference. Lessees who sublease only a portion of the tract for the entire term must be judged on a case-by-case basis to determine whether the goals of sustained yield are being met as required in Jerke.
2. Lessees who sublease all or part of the tract for only a part of the term will lose their preference right if, on a case-by-case basis, it is determined that the goals of sustained yield are not being met as required in Jerke.
3. The holdings in Skillman and Jerke must be applied to leases as they come up for renewal.
4. A lessee who violates his lease loses his right to renew or the preference right only if the Board determines that the violations are serious enough to warrant cancellation.
5. Lease reinstatement pursuant to section 77-6-211, MCA, restores the preference right to a lessee who has violated the terms of his lease.
6. An assignee of a lessee who has violated the terms of his lease enjoys all rights of a new lessee who has not violated the terms of his lease.

Very truly yours,

MIKE GREELY
Attorney General